

Quiz Bomb (From Business Finance)

Chapter 1: Introduction

Indicate whether the following statements are 'True' or 'False'. Support your answer with reason:

1. The primary goal of financial management decisions is to maximize the price of the firm's stock.

Solution: True. The primary goal of the financial management is to maximize the stock price because this objectives considers all stakeholders. If the price of stock is maximized, all parties related with companies will be benefited.

2. Finance is related with the acquisition, allocation, management and efficient utilization of firm's financial resources.

Solution

True. Financial management is related with acquisition and utilization of money by the firm which includes allocation and management of money.

3. The primary emphasis of the financial manager is on profit maximization.

Solution

False. Primary emphasis of financial manager is to maximize stock price because this goal considers all parties related with the firm.

4. The primary goal of the management is stockholder wealth maximization.

Solution

True. Primary goal of the management is to stockholder wealth maximization because it considers all parties realted with the firm.

5. Risk management in the most crucial responsibility of financial manager.

Solution

True. Financial manager should mananage risk for his/her firm by purchasing insurance policy and by hedging tools.

6. The objective of profit maximization considers the time value of money.

Solution

False. Profit maximization does not consider the time value of money and two equal profit projects provides the equal weight.

7. A high earnings per share represents the higher stock price of the corporation.

Solution

True. Stock price is the product of price earnings ratio and earnings per share. Stock price depends on the earning per share, thus higher the earnings per share higher will be the stock price and vice versa

8. Investment decision is also known as capital structure decision.

Solution

False. Investment decision is the decision related with the purchase of fixed asset. On the other hand, capital structure decision is the selection of optimal mix of long term sources of financing.

9. The treasurer oversees the accounting activities of the firm.

Solution

False. Treasurer oversees the financing activities and controller oversees the accounting activities.

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10. For a firm wealth maximization goal is preferable to profit maximization goal.
Solution
True. Wealth maximization goal is preferable than profit maximization because wealth maximization goal is clear, consider risk element and time value of money.
11. Financial manager places primary emphasis on cash flows.
Solution
True. Value of the firm is derived from the cash flows so financial manager must emphasis on cash flows. Bigger the cashflows bigger the value of the firm and viceversa.
12. Financial management is concerned with the maintenance and creation of wealth.
Solution
True. Goal of the financial management or financial manager is to maximize the wealth of the firm and maintain in consistent level.
13. Shareholder wealth is measured by the market value of the firm's common stock.
Solution
True. Shareholder wealth is measured by the market value of the firm's common stock. If the market value of the firm's share is increased, then the value of the firm is increased.
14. Financial manager has close relation with financial market.
Solution: True. Performance of the financial manager shown in the market by increasing in the stock price. So, there is close relationship with financial market.
15. Day to day functions of the finance department are carried out by financial manager.
False. Financial manager (chief financial officer , treasurer , controller, and respective department heads) are responsible for the policy making functions. On the other hand, day to day functions are carried out by lower level staff of respective departments.
16. Public finance is the study of money management of individual.
False. Public finance is the study of management of money by government. On the other hand, money management by individual is called personal finance.
17. Business finance is the study of money management of all forms of business organizations.
True. Money management by all forms of business organization (sole, partnership and corporation) is called business finance.
18. Public finance is the management of money in public corporation.
False. Public finance is the management of money by government. On the other hand, the money management by public corporation is called corporate finance.
19. Conflict of interest between shareholders and managers, shareholders and creditors is called agency problem.

True. There is conflict between owners and managers due to own interests. This agency problem is first agency problem. Second agency problem is conflict between shareholders and creditors.

20. Primary market provides liquidity to the investors.
False. Primary market provides funds to the issuer and secondary market provides the liquidity to the investors.

Chapter 2: Financial statements, taxes, cash flow and analysis

State whether the following statements are true or false with reasons:

1. If the equity multiplier is 2.0, the debt ratio must be 0.50.
True. Debt ratio = $1 - \frac{1}{EM} = 1 - \frac{1}{2} = 0.50$
2. The cash flow related to interest payments less any net borrowing is called the cash flow from assets.
False. The cash flow related to interest payments less any net borrowings is called cash flow from creditors. On the other hand, cash flow from assets is equal to the sum of cash flow to the creditors and cash flows to the stockholders. Alternatively cash flow from assets equals to operating cash flow + depreciation – taxes
3. The percentage of next rupee you earn that must be paid in taxes is referred to as the average tax rate.
False. Taxes paid in additional investment is known as marginal tax rate.
4. Net working capital increases when inventory is purchased with cash.
False. If inventory is purchased with cash then there is no change in current assets and therefore there is no effect on net working capital.
5. The higher the degree of financial leverage employed by a firm, the higher the probability that the firm will encounter financial distress.
True. Higher the degree of financial leverage, higher will be the financial risk and higher will be the return on equity and high chance of financial distress.
6. Depreciation increases the marginal tax rate.
False. Depreciation decreases the marginal rate rate because depreciation reduces the taxable amount.
7. Additional income is taxed at a firm's average tax rate.
False. Additional income is taxed at firm's average tax rate.
8. An increase in depreciation will increase the operating cash flow.
True. Operating cash flow = EBIT + depreciation – taxes
Higher the depreciation, higher will be the operating cash flows and vice versa.
9. Net income divided by the number of shares outstanding will equal the dividends per share.
False. Net income divided by number of shares outstanding is the earnings per share.
10. A positive cash flow to creditors represents a net cash outflow from the firm.
True. Cash flow to creditors = Interest paid – net new borrowing
If cash flow to creditors is positive then interest payment must be higher than borrowing, therefore the positive cash flow to creditors represents a net cash outflow from the firm.
11. A common size income statement is an accounting statement that expresses all of a firm's expenses as percentage of total assets.

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False. In common size analysis, all balance sheet items expressed as a percent of total assets and all income statement items expressed as percent of sales.

12. An equity multiplier of 1.2 means a firm has Rs 1.20 in sales for every Rs 1 in equity.

False. Equity multiplier = $\frac{\text{Total assets}}{\text{Common equity}} = \frac{1.20}{1} = 1.20$. Therefore, equity multiplier of 1.2 means that a firm has Rs 1.20 in assets for every Rs 1 in common equity.

13. If a firm has a debt to equity ratio of 1.0, then its total debt ratio must be 0.50.

True. D/E ratio = $\frac{D/A}{1 - D/A} = \frac{0.50}{1 - 0.50} = 1$

14. If a firm produces a twelve percent return on assets and also a twelve percent return on equity, then the firm has equity multiplier of 1.0.

True. According to DuPont Equation

ROE = ROA × EM Or, 12% = 12% × EM Or EM = 1

15. Generally, firms with high profit margins have high asset turnover ratios and firms with low profit margins have low turnover ratios; this result is exactly as predicted by the extended DuPont Equation.

False. According to DuPont equation

ROA = Profit margin × Total assets turnover

If profit margin is high then the ROA will be higher and vice versa.

16. When the present financial ratios of a firm are compared with similar ratios for another firm in the same industry it is called trend analysis.

False. This comparison is known as cross sectional analysis. Trend analysis is the analysis of past ratios of same company.

17. According to the DuPont Analysis, an increase in net profit margin will decrease return on assets.

False. According to DuPont equation

ROA = Profit margin × Total assets turnover

If profit margin is high then the ROA will be higher and vice versa.

18. The lower the average collection period ratio, the more efficient is the firm in managing its investment in accounts receivable.

True. Lower the average collection period, the more efficient the accounts receivables management.

19. Current assets consist of cash, accounts receivable, inventory, and net plant, property, and equipment.

False. Current assets are the assets that are convertible into cash within a year.

Current assets consist of cash, accounts receivables, and inventory.

20. For the average firm, inventory is considered to be more "liquid" than accounts receivable.

False. Inventory is less liquid than receivable because inventory can not be converted into cash at their book value.

Chapter 3: Time value of money

State whether the following statements are true or false with reasons:

1. Compound interest pays interest for each time period on the original investment plus the accumulated interest.

True. Compound interest means earning interest on interest. If interest for one period is added to the principal to get the principal for the next period, this is called compounding of interest. For example our banking system uses quarterly compounding.

2. When money is invested at compound interest, the growth rate is the interest rate.

True. If we deposit money at bank and the money will grow by the interest rate in quarterly compounding basis. Therefore the interest rate is the growth rate of money.

3. For a given amount, the lower the discount rate, the less the present value.
False. There is inverse relationship between present value and discount rate and if discount rate is lower than the present value will be higher.
4. An effective annual rate must be greater than an annual percentage rate.
False. Effective annual rate is equal with annual percentage rate if there is annual compounding. Other than annual compounding, EAR is always greater than APR.

5. The more frequent the compounding, the higher the future value, other things equal.

True. Higher the compounding period, more the money will grow thus the future value will be higher. For example, other things being same, highest future value will achieve at continuously compounding.

6. A perpetuity is a special form of an annuity.
True. Perpetuity is the perpetual annuity i.e. annuity will received forever. for example, the bond issued by the British Government is perpetuity.

7. If the discount (or interest) rate is positive, the present value of a series of cash flows will always exceed the future value of the same series.

False. If there is interest rate, the future value is always greater than present value because money will grow at given interest rate. If there is no interest than present and future value will be equal.

8. If other things remain the same, the more frequently your money is compounded; the lower is the effective rate.

False. Higher the compounding period, higher will be the effective rate because of higher the compounding. For example, there are two compounding one is semiannual and another is quarterly. In case of quarterly compounding, effective rate will be higher.

9. The present value of annuity due factor of Rs 1 at a discount rate of 15 percent for 15 years is 5.8474.

False. $PVIFA_{due} = PVIFA_{i,n} (1 + i) = PVIFA_{15,15} (1 + 0.15) = 5.8474 (1 + 0.15) = 6.7245$

10. An amortized loan is a loan that requires equal payments over its life; its payments include both interest and repayment of the debt.

True. Under amortized loan total payment consists of principal plus interest and interest will be higher in earlier periods and principal will be lower.

11. An annuity is a series of equal payments made at fixed equal-length intervals for a specified number of periods.

True. Annuity is the series of equal payments made in equal interval for specified number of periods.

12. The difference between an ordinary annuity and an annuity due is that each of the payments of the annuity due earns interest for one additional year (period).

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True. In annuity due, the cash flows will occur one period earlier and can be reinvested for additional one period than ordinary annuity.

13. If annual compounding is used, the effective annual rate equals the simple rate.
True. In case of annual compounding, effective annual rate is equal with simple rate because there is only one compounding period in a year.
14. The annual payments would be larger if the interest rate were lower.
False. If the interest rate were lower, then the annual payment be lower because total payment consists of interest plus principal.
15. All else equal, the future value of a lump-sum amount invested today will increase if the number of compounding periods is increased.
True. Higher the compounding periods, higher will be the future value because money will grow at quickly.
16. Present value of future cash receipt due to holding security is the current price of that security.
True. Current price of the security is the present value of future cash flows expected from that security.
17. Other things remaining the same, future value of an ordinary annuity is lower than the future value of the annuity due of the same magnitude.
True. Future value of an ordinary annuity is always lower than the future value of ordinary annuity because in ordinary annuity there is one period less for compounding.
18. The loan to be repaid in equal periodic installments is called amortized loan.
True. Equal periodic installment loan is called amortized loan because loan will be paid off by every installment payment.
19. Present value of an annuity due is always higher than ordinary annuity.
True. Present value of an annuity due is always higher than ordinary annuity because one period higher in annuity due for interest earnings.
20. Value of present value interest factor annuity is always greater than value of present value interest factor.
False. At time zero, there is equal value of present value interest factor annuity and present value interest factor. Except this condition, PVIFA is always greater than PVIF at any interest rate and periods.

Chapter 4: Risk and Return

Indicate whether the following statements are 'True' or 'False'. Support your answer with reasons.

1. The holding period rate of return on an investment must always be expressed in annual basis.
False. Holding period return can be calculated in any periods like one day, 1 week, 1 month, 1 year, 2 years and so on.
2. The one-period return on common stock is a combination of income paid to the shareholder plus any appreciation in stock price, divided by the beginning price.
True. One period return = $[D_1 + (P_1 - P_0)]/P_0$
3. For a common stock, the current yield is equivalent to the dividend yield.
True. Current yield = dividend yield = D_1/P_0
4. Standard deviation measures the standard risk of a security.
False. Standard deviation measures the total risk of a security.

5. If two investments offer the same expected return, most investors would prefer the one with higher variance.
False. If the two investments offer the same expected return, then the investor should select the investment with low variance because we assume investors are risk averse.
6. Coefficient of variation is the absolute measure of riskiness of business.
False. Coefficient of variation is the relative measure of risk.
7. There are two securities, security 1 with expected return of 8% and standard deviation of 10%, and security 2 with 8% expected return with 9% standard deviation. For risk averse investor, security 1 should be accepted.
False. Security 2 should be accepted because it has lower standard deviation with same expected return.
8. The total risk of an investment project is measured by its coefficient of variation.
False. Total risk is measured by standard deviation and total risk in relative and per unit basis is measured by coefficient of variation.
9. A risk averse person will normally not take a risk.
False. Risk averse person will take higher risk if there is high reward.
10. Two assets whose returns move in the opposite direction and have a negative correlation coefficient are either risk free assets or low risk assets.
False. If the returns of two assets moves in opposite direction then the correlation must be negative and diversification benefits will be higher in negative correlation stocks portfolio.
11. The risk of a portfolio consisting of two negatively correlated stocks will be lesser than the portfolio consisting of positively correlated stocks.
True. The risk of a portfolio having negatively correlated stocks will be lower than the risk of a portfolio having positively correlated stocks.
12. When securities are combined into portfolios, the relevant risk is a security's non systematic risk.
False. Non-systematic risk can be reduced to zero and systematic risk can not be reduced so relevant risk is systematic risk.
13. A stock's risk consists of company specific risk, which cannot be eliminated by diversification, plus market risk, which can be eliminated by diversification.
False. Stock's risk consists of company specific risk that can be reduced to zero and market risk that can not be reduced.
14. If a firm is considering purchasing an asset whose beta is greater than the current beta of the firm, it should use a discount rate greater than the firm's cost of capital to evaluate the possible investment.
True. If the risk is higher than the required rate of return should be higher should be used.
15. The market risk is the type of risk that can be diversified.
False. Market risk is the systematic risk that cannot be reduced because it arises due to macroeconomic factors.
16. The most important characteristic in determining the expected return of a well-diversified portfolio is the variance of the individual assets in the portfolio.
False. Expected return of any portfolio is the weighted average rate of return.
17. Unexpected returns over time have a negative effect on the total return of a

firm.

False. Unexpected returns may have positive return on total return.

18. The expected return minus the unexpected return is equal to the total return.

False. Expected return plus unexpected return equals total return.

19. If a stock's expected rate of return plots below the security market line, it is underpriced.

False. If the expected return plots below security market line, the stock is overpriced because its required return must be greater than expected return.

20. The CAPM assumes that individual investors are compensated for assuming unsystematic risk.

False. Unsystematic risk can be reduced to zero so investors does not demand extra return for the compensation.

Chapter 5: Bond valuation and interest rates

Indicate whether the following statements are 'True' or 'False'. Support your answer with reasons.

1. If the coupon rate of a bond is greater than the market interest rate of the bond, the market price of the bond is greater than the face value of the bond.

True. If the market interest rate is higher than the coupon rate then bond is selling at premium i.e. more than Rs 1,000 and price will be higher than par value.

2. For bonds, price sensitivity to a given change in interest rates generally increases as years remaining to maturity increase.

True. Higher the maturity higher will be the price sensitivity to a given change in interest rates and vice versa.

3. A bond that sells below its par value is called premium bond.

False. A bond that sells below its par value is called discount bond.

4. The interest rate price risk refers to the risk of declines in bond prices to which investors are exposed due to increasing interest rates.

True. Interest rate price risk is the risk of declines in bond prices to which investors are exposed due to change in interest rates.

5. The annual interest payment on a bond divided by its current market value is called the yield to call.

False. The annual interest payment divided by the current market value is the current yield.

6. The rate of return on a bond if it is held to maturity is called the bond's current yield.

False. The rate of return on a bond if it held to maturity is called the bond's yield to maturity.

7. Call provision in a bond contract gives the issuer the right to pay off the bonds prior to the stated maturity date.

True. Call provision gives the issuer the right to redeem bonds prior to maturity date at call price if the conditions is favourable to the company.

8. Zero coupon bond is sold at a discount below par, thus providing compensation to investors in the form of capital appreciation.

True. Zero coupon bond is sold at discount and it provides capital gains at maturity.

9. The difference between the price that a dealer is willing to pay and the price at which he or she will sell is called the spread.

True. Spread = Asked price - bid price.

10. The call price must equal the par value.
False. Call price consists of par value plus call premium and call premium consists of 10 to 20 percent premium of par value.
11. An increase in market rates increases the market price of a bond.
False. Market interest rates decreases the value of the bond. There is inverse relationship between market interest rate and value of bond.
12. Decreasing the time to maturity increases the price of a discount bond, all else constant.
True. Discount bond is issued with discount and when the maturity periods become closed to the maturity then its value increases to Rs 1,000 at end.
13. Increasing the coupon rate decreases the current yield, all else constant.
False. Coupon rate increases the current yield other things remains the same.
14. The risk-free rate represents the change in purchasing power.
False. Risk free rate = Real rate + Inflation premium . thus, risk free rate represents the real rate plus change in purchasing power.
15. Any return greater than the inflation rate represents the risk premium.
False. Risk premium is the difference between return of risky assets less risk free rate.
16. Nominal rates exceed real rates by the amount of the risk-free rate.
False. Nominal rate = Real rate + Various risk premiums
17. The real rate must be less than the nominal rate given a positive rate of inflation.
True. Nominal rate = Real rate + Inflation rate
18. Expectations of lower inflation rates in the future tend to lower the slope of the term structure of interest rates.
True. Lower the inflation expected, lower will be the future interest rates and lower the slope of the term structure of interest rates.
19. The term structure of interest rates includes both an inflation premium and an interest rate risk premium.
True. Term structure includes all types of risk premiums.
20. The term structure of interest rates and the time to maturity are always directly related.
False. There may be three relationship between interest rates and maturity period. There may be flat, upward and downward.

Chapter 6: Stock valuation

Indicate whether the following statements are 'True' or 'False'. Support your answer with reasons.

1. In general, the common stock price is the present value of all expected future dividends.
True. Common stock price is the present value of future dividend expected by the investors.
2. Dividend yield is dividend by stock's par value.
False. Dividend yield is the ratio of dividend divided by market price.
3. There is a direct relationship between the value of a firm's stock and its required rate of return.
False. There is inverse relationship between value of firm's stock and its required rate of return. Higher the required rate of return, lower the value of stock and vice versa.

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4. The growth rate of a firm's dividends and a firm's stock value are inversely related.
False. Growth of dividend and firm's stock is directly related. Dividend, earnings and stock price will grow at same rate.
5. With the constant growth model, the dividend yield can not be greater than the stock's required return.
False. In constant growth model, growth rate must not be greater than required return. If this happen then the value of stock will be meaningless.
6. A necessary condition to use the constant growth model is that the required rate of return should be greater than the growth rate.
True. The major assumption of constant growth model is that the required rate of return must be greater than the growth rate.
7. The constant growth model is invalid if growth rate equals zero.
True. The required rate of return must be greater than the growth rate to valid the model. Otherwise the model will be invalid.
8. For a constant growth firm, the expected capital gains yield is constant, but the expected dividend yield is not.
False. For constant growth firm, the required rate of return must be constant and it consists of dividend yield and capital gain or loss yield.
9. The value of perpetual preferred stock is found as the dividend divided by the required rate of return.
True. Value of perpetual preferred stock is the dividend divided by the required rate of return because this is the case of perpetuity.
10. The value of preferred stock depends on preference dividend and the growth rate of the firm.
False. There will be no growth in preferred stock because this is fixed income security and value of stock depends on the dividend and required rate of return.
11. For a common stock, the current yield is equivalent to the dividend yield.
True. Current yield = dividend yield = dividend / current price
12. The preemptive right gives shareholders the right to maintain their percentage ownership in the firm.
True. Preemptive right gives shareholders the right to maintain their percentage ownership in the firm by purchasing the stock of the company.
13. Preferred stockholders have preferential voting rights over common stockholders.
False. There is no voting right for preferred stock holders because they are fixed income security holders.
14. Common stock represents a claim on residual income.
True. In liquidation, the priority of claim is last in case of common stock holders so commonstockholders are the residual owners.
15. The stockholder's expected rate of return consists of a dividend yield and interest.
False. Stockholder's expected rate of return is the sum of dividend yield plus capital gains or loss yield.
16. Supernormal growth is a growth rate that is unsustainable over the long term.
True. Supernomal growth is the rate for certain period and after that peiroad the high growth rate will decline to constant rate and it will be continue forever.

17. Preferred shareholders are considered to be the residual owners of a corporation.
False. Common stockholders are considered to be the residual owners of the corporation.
18. Preferred stock, unlike bonds, cannot be converted into common stock.
False. Preferred stock can be converted into common stock at the will of investors.
19. The cumulative feature is necessary to protect the rights of preferred stockholders.
True. Cumulative preferred stock protect the preferred stockholders by carry forward the dividend if there is loss in particular year.
20. Preferred stock cannot be retired.
False. Redeemable preferred stock must be retired at maturity. But in case of perpetual preferred stock, it can not be retired i.e. it will be for perpetuity.

Chapter 7: Capital budgeting analysis

Indicate whether the following statements are 'True' or 'False'. Support your answer with reason:

1. The net present value profile is a graph showing how a project's NPV changes as the IRR changes.
False. NPV profile is a graph which shows the how a project's NPV changes with change in cost of capital.
2. Both the IRR rule and the accounting rate of return rule take into consideration the time value of money.
False. False. IRR rule consider the time value of money and accounting rate of return does not consider the time value of money.
3. The NPV of a project will equal zero whenever the payback period of a project equals the required rate of return.
False. False. NPV of a project will equal zero if the required rate of return of the project must be equal with its internal rate of return.
4. NPV is a better capital-budgeting technique than IRR.
True. NPV is a better capital budgeting technique because it measures the firm's value in rupees and there will be only one decision. But in case of IRR, there may be multiple IRR.
5. The NPV assumes cash flows are reinvested at the firm's cost of capital.
True. NPV method assumes cash flows from the project are reinvested at firm's cost of capital.
6. Projects with nonnormal cash flows sometimes have multiple MIRR.
False. If there is nonnormal cash flows there will be multiples IRR but in case of MIRR there is no multiple MIRR there is only MIRR in case of nonnormal cash flows.
7. The IRR of a project whose cash flows accrue relatively rapidly is more sensitive to changes in the discount rate than is the IRR of a project whose cash flows come in more slowly.
False. False. Because the IRR is independent of the discount rate.
8. There are many conditions under which a project can have more than one IRR. One such condition is where an otherwise normal project has a negative cash flow at the end of the life.

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- True. The situation identified is that of a project with nonnormal cash flows, which has multiple IRRs.
9. The phenomenon called multiple internal rates of return arises when two or more mutually exclusive projects that have different lives are being compared.
False. Multiple IRRs occur with projects with nonnormal cash flows, not with mutually exclusive projects with different lives.
 10. The modified IRR method has wide appeal to professors, but most business executives prefer the NPV method to either the regular or modified IRR.
False. Business executives tend to prefer the IRR because it gives a measure of the project's safety margin.
 11. If a project has an NPV greater than zero, then taking on the project will increase the value of the firm's stock.
True. If the NPV is greater than zero, the value of firm will increase by NPV amount.
 12. Underlying the IRR is the assumption that cash flows can be reinvested at the firm's cost of capital.
False. The IRR assumes reinvestment at the IRR.
 13. The discounted payback period always leads to the same accept /reject decisions as the NPV method.
False. Since the discounted payback ignores cash flows beyond the payback period, it could lead to rejections of projects with high late cash flows and hence $NPV > 0$.
 14. Under mutually exclusive projects we can choose both projects.
False. If two projects are mutually exclusive (that is, only one can be accepted), the one with the higher NPV should be chosen, assuming that the NPV is positive. If both projects have negative NPVs, neither should be chosen.
 15. Under independent projects can be accepted or rejected individually.
True. Independent projects can be selected independently because there is no effect by selecting one project to others. All projects having positive NPV are accepted assuming unlimited budget.
 16. You are thinking of buying a motorbike. You are considering (i) Hero Honda (ii) CBZ (iii) Yamaha and (iv) Pulsar. This is an independent case.
False. We are choosing one out of three so this is mutually exclusive case.
 17. While calculating relevant cash flows for capital budgeting decision, additional working capital represents cash inflow at the end of project period.
True. If working capital is additional in zero year then it will be released at the end of project period and it will be cash inflow at the end of the project.
 18. Project that adds the capacity to the existing one to increase the output or increase the distribution channel is termed as replacement project.
False. It is expansion project. In expansion project, a company may add capacity to its existing product lines to expand existing operations. For example, a fertilizer company may increase its plant capacity to manufacture more urea.
 19. As an expansion project, a company is considering selling a truck used for delivery of its products and purchasing two new vans for same delivery purpose.
False. This is replacement project. Companies invest in two new vans by replacing truck, so this is replacement project.
 20. If cost of capital is more than the crossover rate, there is no conflict in decisions given by net present value and internal rate of return techniques.

True. If the cost of capital is more than the crossover rate there will be no conflict because decision will be same accept or reject. Below crossover rate there will be conflict.

Chapater 8: Working capital management

Indicate whether the following statements are 'True' or 'False'. Support your answer with reasons.

1. An increase in cash sales increase a firm's investment in accounts receivables.
False. Increase in cash sales does not affects the investment in accounts receivables.
2. A decrease in the average collection period increase a firm's investment in accouns receivable.
False. Decrease in average collection period decreases the firm's investment in accounts receivable.
3. The credit terms of 1/5, net 15 indicates that if you pay within 1 day you will receive a 5 percent discount.
False. 1 percent discount is offered if the invoice amount is paid within 5 days.
4. The discount period is the length of time granted to a customer to pay for a purchase.
False. Discount period is the leghth of time for which discount is given.
5. With terms of 2/10, net 30, the net credit period is 20 days.
False. Net credit period is 30 days. One must pay the credit amount within 30 days.
6. The credit period begins on the invoice date.
True. The credit period begins on the invoice date at which date the credit agreement is done.
7. When credit policy is at the optimal point, the total costs of granting credit will be maximized.
False. At optimal credit, the total cost will be lower.
8. When evaluating the creditworthiness of a customer, the term character refers to the nature of the cash flows of the customer's business.
False. The term character refers to the willingness to pay the credit.
9. An aging schedule helps identify those customers who are the most delinquent.
False. Aging schedule shows the age of accounts receivable.
10. The EOQ model is designed to determine how much total inventory a firm needs in any one year.
False. EOQ model determine the optimal order quantity that minimize the total cost of inventory.
11. The cash management primarily involves determining the best method of raising capital.
False. Cash management involves the management of optimal level of cash.
12. Depreciation is always shown in a cash flow forecast.
False. Depreciation is non cash outlay so it is not shown in cash flow forecast.
13. Inventory manager should maintain low level of inventory.
False. Inventory manager should manaintain the optimal level of inventory that should maximize the value of the firm.

QUIZ BOMB

14. The carrying costs of inventory are those combined costs of storing, handling, and insurance and do not include the opportunity cost of funds.
False. Carrying costs involves the costs related to holding the inventory including opportunity costs.
15. The best credit standard policy is one that minimizes bad debt losses.
False. The best credit standard policy is one that maximizes the value of the firm.
16. One objective of cash management is to obtain reasonable interest income on any temporarily idle funds.
True. The objective of cash management is to earn interest from idle cash.
17. The optimal level of working capital is that which provides a 2:1 ratio of current assets to current liabilities.
False. Optimal level of working capital is that which provides the current assets and liabilities near to industry average level.
18. In working capital management we find that profitability varies inversely with liquidity.
True. Higher the liquidity and higher will be holding of liquid assets and it decreases the profitability. Thus, there is inverse relationship between liquidity and profitability.
19. If company holds the cash, the return on equity will increase.
False. If company holds the cash then cash will be idle and return on equity decrease.
20. Semi finished good is the example of type of inventory.
True. Semi finished good is type of inventory which is used by manufacturing company.

